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## Federal Adoption Tax Credit for Special Needs Adoptions

Beginning in 2003, families adopting a child with special needs from foster care were able to access a federal adoption tax credit without needing to document expenses. For tax year 2006, the tax credit is \$10,960 per child and parents have this year and up to the next five years in which to claim the credit. **(Note: Families who finalized an adoption of a child with special needs between 2003 and 2005 who did not claim the adoption tax credit should read *Amending a Tax Return from a Previous Year on page 3.*)** Below we answer some of the common questions about the federal Adoption Tax Credit.

### Accessing the Tax Credit

#### How do I know if my child is considered to have special needs according to the IRS?

NACAC interprets the instructions for Form 8839 (the Adoption Tax Credit form) this way: If you receive adoption subsidy (assistance) for your child, the state that provides the subsidy has determined that your child has special needs. Your adoption subsidy agreement (or application and agreement) is the evidence that the state has determined your child to have special needs. These instructions (found at [www.irs.gov/instructions/i8839/ch02.html#d0e284](http://www.irs.gov/instructions/i8839/ch02.html#d0e284)) state:

A child is a child with special needs if all three of the following statements are true.

1. The child was a citizen or resident of the United States or its possessions at the time the adoption process began.
2. A state (including the District of Columbia) has determined that the child cannot or should not be returned to his or her parents' home.
3. The state has determined that the child will not be adopted unless assistance is provided to the adoptive parents. Factors used by states to make this determination include:
  - a. The child's ethnic background and age,
  - b. Whether the child is a member of a minority or sibling group, and
  - c. Whether the child has a medical condition or a physical, mental, or emotional handicap.

***If you check the box in column (d), indicating the child has special needs, be sure to keep evidence of the state's determination in your records.***

If your child does not receive an adoption subsidy, NACAC believes then the state has not determined that your child has special needs and you will not be able to take the credit without documenting expenses for the cost of the adoption.

## What will the federal Adoption Tax Credit mean for our family?

While every family's taxes are different, we can provide information to help you figure out what the credit means for you. How much, if any, of the credit you can use is based on: (1) your income (families with federal adjusted gross income above \$204,410 cannot claim the credit at all); and (2) your total federal tax liability. In one year, your credit can be up to the full amount of your federal income tax liability. The amount of your tax liability (line 46 of Form 1040) based on your taxable income.

Many people believe the federal Adoption Tax Credit won't help them because they already get a refund every year, but that isn't necessarily true. A refund means you have paid more federal income tax than you needed to, so the IRS refunds the amount overpaid. The tax credit is applied against what your total tax liability is and could increase your refund. Here are some examples of how the tax credit works:

- Family one is a couple that adopted a sibling group of two children with special needs. They had \$6,500 in federal income tax withheld from their paychecks in 2006, and their tax liability is \$7,000, which means they would owe \$500 in April. With the adoption tax credit, they have \$21,920 in credits, and they can use up to \$7,000 of the credit this year.\* They get a refund of \$6,500, and will have \$14,920 of adoption tax credit to carry over for up to five years.
- Family two is a single mother who adopted a sibling group of three children with special needs. She had \$5,000 in federal income tax withheld from her paychecks, but her total tax liability is only \$4,000, which means she would receive a refund of \$1,000 in April. She has \$32,880 in the adoption tax credit, so she can use up to \$4,000 of the credit (her total tax liability).\* She will get a refund this year of \$5,000, and can carry over \$28,880 of the tax credit for up to five years.
- Family three is a couple with five other children who adopted a sibling group of two children with special needs. They had \$1,000 in federal income tax withheld from their paychecks, and their tax liability is \$0, which means they would receive a refund of \$1,000 in April. Since they have no tax liability, they are unable to use any of the possible \$21,920 adoption tax credit this year. They should still claim the tax credit on their tax return because it must be claimed in the year the adoption was finalized. The credit would carry forward for up to the next five years and would go into effect if their tax liability is greater than zero in those future years.

## Filling out Form 8839

### What do I do when the IRS asks for qualifying expenses on line 5?

The Instructions for Form 8839 state: *“But, if you adopted a child with special needs and the adoption became final in 2006, enter \$10,960 on line 5.”*

You do NOT have to document qualifying expenses to take the credit, and should simply enter the full \$10,960 on that line.

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\* The amount of the adoption tax credit may be reduced if you claim other credits such as the Education Credits or Retirement Savings Contribution Credit.

## What if my tax liability is less than \$10,960?

You will need to fill out the Credit Carryforward Worksheet of the Instructions for Form 8839. This documents the amount of the credit you can carry forward for up to the next five years or until it is used up, whichever is sooner. (You do not need to submit this worksheet.)

## Amending a Tax Return From a Previous Year

### Should I amend my previous tax returns?

If you finalized an adoption of a child with special needs in 2003, 2004, or 2005 and you did not claim the federal Adoption Tax Credit you should consider amending your tax return so you can take advantage of the credit. **Note: If you finalized an adoption of a child with special needs in 2003 and you need to amend your return, you must amend that return by April 15, 2007.**

If your adoption occurred in a previous year, the IRS requires you to amend the tax return from the year the adoption took place. For example, if you finalized the adoption on June 16, 2004, you will need to amend your 2004 tax return. If you can't use the full amount of the Adoption Tax Credit in 2004, you will also need to amend your 2005 tax return in order to access the remaining amount of the tax credit.

Not all families are able to use the adoption tax credit. If you do not have federal income tax liability, you cannot use the credit. To determine what your tax liability was for previous years, if you filed Form 1040A, you need to look at Line 28. If you filed Form 1040, then you will look at Line 43 in 2003, Line 45 in 2004, and Line 46 in 2005.

If your tax liability equals zero, then claiming the adoption tax credit will not change your tax return status that year. However, if you adopted a child in 2003 and Line 43 of your Form 1040 is zero, you should still check your tax returns for 2004 and 2005 to see if amending the 2003 return to claim the credit will help you get a refund in 2004 or 2005.

For example, consider that Line 43 of our Form 1040 was \$0 in 2003, but Line 45 was \$756 in 2004, and Line 46 was \$563 in 2005. Even though claiming the credit wouldn't change your 2003 return, you may get additional refunds totaling \$1,319 for 2004 and 2005.\*

### How do I amend my tax returns?

If you paid someone to prepare your taxes, you should ask them to amend your taxes. It may be free since they failed to include the Adoption Tax Credit.

If you are doing your own taxes, you will need Form 1040X, which can be found at [www.irs.gov/pub/irs-pdf/f1040x.pdf](http://www.irs.gov/pub/irs-pdf/f1040x.pdf). You will need copies of the returns you filed for the years you are amending plus Form 8839 for the year that you finalized your child's adoption. You can access this form at [www.irs.gov/formspubs/article/0,,id=98339,00.html](http://www.irs.gov/formspubs/article/0,,id=98339,00.html).

If you are only amending the tax credits, you can start with line 6 of Form 1040X.

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\* The amount of the adoption tax credit may be reduced if you claim other credits such as the Education Credits or Retirement Savings Contribution Credit.

## Claiming the Child Tax Credit

If you can claim your child as a dependent, then you should also look into how to claim the Child Tax Credit. In years that you are using the Adoption Tax Credit and the Child Tax Credit, you will need to use the worksheet in *Publication 972, Child Tax Credit*.

**Note—if you checked Yes on line 13 of the worksheet you may be eligible to take the Additional Child Tax Credit. The Additional Child Tax Credit is a refundable tax credit, which means you may receive more money in a refund than your total tax liability (unlike the Adoption Tax Credit). To claim this credit, you will need to complete *Form 8812, Additional Child Tax*.**

## Additional Questions

If you have questions related to adoption subsidy and taxes, read NACAC's fact sheet *Tax Issues Related to Adoption Assistance and Adoption*, found at [www.nacac.org/subsidyfactsheets/taxes.html](http://www.nacac.org/subsidyfactsheets/taxes.html).

If you have additional questions on the adoption tax credit, contact the North American Council on Adoptable Children at 651-644-3036 or [adoption.assistance@nacac.org](mailto:adoption.assistance@nacac.org).